

## **Controversies in Tax Law:**

### **A Matter of Perspective**

Edited by Anthony C. Infanti

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## Chapter 1

### Introduction

Anthony C. Infanti

#### **The Project**

Despite beginning with the word “controversy,” the title of this volume should itself be without any controversy whatsoever. After all, taxation has been a perennial source of debate and unrest in the United States—and it remains none the less so in the early twenty-first century. Historical examples are easily enumerated and include such pivotal events in American history as the Boston Tea Party, Shays’s Rebellion, the Whiskey Rebellion, and the woman suffrage movement.

Though less momentous, early twenty-first century debates are no less consequential. Today’s debates implicate such important questions as who should pay tax—think of Republican presidential candidate Mitt Romney’s remarks during the 2012 campaign about the “47 percent” who pay no income tax at all (even if they do pay other federal, state, and local taxes). Today’s debates also concern the important question of how much each of us should be asked to pay in tax—think of President Obama’s insistence during that same presidential campaign that the Bush tax cuts for those with more than \$250,000 of income should be allowed to expire.

So, when I was asked by the Centre for American Legal Studies at Birmingham City University School of Law to consider editing a tax volume for its “Controversies in ...” series with Ashgate Publishing, I knew that there would be neither a dearth of material nor of individuals willing to contribute to the book. But I wanted to do something more than simply assemble a disconnected collection of opinions about the existing state or

future direction of American tax law. Instead, I wished to approach contemporary tax controversies in a unique fashion—one that required scholars to actively engage with each other’s viewpoints and writings in an attempt to gain a better understanding of why and how their perspectives differ.

The subtitle of the volume—“A Matter of Perspective”—reflects the fact that today’s tax debates often turn on the differing *Weltanschauungen* of the participants in those debates. For instance, a central tension in the academic tax literature—which is filtering into everyday discussions of tax law—exists between “mainstream” and “critical” tax theorists. This tension results from a clash of perspectives: Is taxation primarily a matter of social science or a matter of social justice? In other words, should tax policy debates be grounded in economics or in critical race, feminist, queer, and other outsider perspectives?

Too often the two sides of these academic tax debates simply talk “at” or “past” each other rather than engage in a dialogue with each other. To capture and interrogate—and perhaps even to begin to bridge—what often seems like a chasm between the different sides of academic (and, increasingly, everyday) tax debates, this volume comprises six parts with each part containing a pair of chapters. Each pair of chapters approaches a general area of controversy in the tax laws from different perspectives. In most of these pairs, one chapter will approach the topic from a “mainstream” perspective while the other will approach the same topic from a “critical” perspective. In the other pairs, the perspectives on a given topic will differ in other ways.

In the preparation of this volume, I afforded the authors of each of the chapters in a given pair multiple opportunities to read and incorporate reactions to each other’s chapters in the writing of their own. In the writing and rewriting of their chapters, I asked

the authors to pay specific attention to the influence of perspective both on the issue that they address and on the writing of their own contributions to the debate. In this way, I tasked the contributors to the volume with being actively engaged with each other during the writing of the volume, producing what I hope is a series of chapters that you will find equally engaging.

### **The Chapters: A Preview**

#### *Tax, Gender, and History*

Part I of this volume focuses on the intersection of tax with gender and history. A thorough and meaningful understanding of current tax law is difficult—if not impossible—without an understanding of both the history of the tax laws and the historical context within which those laws were created. The story only becomes richer—even if more troubling—when taxes and history are viewed through the lens of gender. Carolyn Jones and Stephanie McMahon have each contributed a chapter to this volume that views tax and history through the lens of gender, but they see very different things through that lens.

In Chapter 2, Carolyn Jones takes a critical approach in her attempt to retake home economics and demonstrate the discipline’s relevance to current tax reform debates. She starkly contrasts the strong relationship between the work of (male) economists and the shaping of tax policy and administration with the complete failure of tax academics even to notice the relevance of home economics to tax policy and administration. In her contribution, Jones focuses particularly on the work of Hazel Kyrk and other pioneers in the home economics field, who all engaged in social and economic analyses of the home.

These home economists explored questions of ability to pay, control of income, and standards of living—all of which are relevant to contemporary tax reform debates about

imputed income and tax incentives for families. In this way, Jones explains how early home economists ruminated about many issues that are (and long have been) of interest to tax academics and policy makers, but how their ideas and contributions were nonetheless overlooked or ignored. By retaking home economics, Jones asserts that tax academics and policy makers might not only learn something about tax policy and administration but also be pushed to think about these issues in a broader context as well.

In Chapter 3, Stephanie McMahon explains a different way in which women were overlooked in the formation of tax policy. She examines the failure, at the time, to grasp the gender dimensions of the tension that the Tax Reform Act of 1969 created between married and single taxpayers. Among other things, the Tax Reform Act of 1969 reduced the singles tax penalty by ensuring that a single taxpayer with the same income as a married couple would pay not in excess of 120 percent more than the married couple did in taxes. By reducing the tax penalty on singles, however, the Tax Reform Act of 1969 created a marriage penalty for couples in which both spouses worked and earned relatively equal amounts of income. (The Tax Reform Act of 1969 maintained the preexisting marriage “bonus” for couples with a single income earner.)

McMahon acknowledges that reinforcement of the traditional family norm likely influenced policy makers—whether consciously or unconsciously—when they were crafting the Tax Reform Act of 1969. But McMahon complicates this critique, which is often leveled by critical tax scholars against treating the married couple as a taxable unit, by exploring how divergent interests among various groups of women—coupled with co-optation of gender by those who simply wished to achieve tax reduction—limited the influence of women and women’s interests on the shape of the taxable unit and the debate

over the marriage penalty. Or, as McMahon puts it, “the marriage penalty [became] gendered but insufficiently so to force its repeal.”

### *Taxation of Imputed Income*

Picking up on a thread in Carolyn Jones’s contribution, Part II concerns the taxation of imputed income—with a particular focus on the long-standing debate over whether to tax imputed income from owner-occupied dwellings. Henry Ordower and Steve Johnson provide a nice point-counterpoint in their contributions to this volume, with one taking a critical perspective and the other a mainstream perspective on this issue.

In Chapter 4, Henry Ordower takes a distinctly critical perspective and centers his attention on the fairness of the implicit exclusion from taxation of imputed income produced by owner-occupied dwellings. After examining the exclusion using the core tax policy principles of horizontal and vertical equity, Ordower concludes that the exclusion violates both of these principles. The exclusion violates horizontal equity because it treats similarly situated taxpayers dissimilarly; that is, homeowners are permitted to pay for occupancy of their homes with untaxed income while renters must pay for occupancy of their homes with taxed income. This differential treatment of homeowners and renters leads, in turn, to a violation of vertical equity because high-income taxpayers are much more likely to be homeowners than lower-income taxpayers.

Ordower then examines this class-based distinction through the lens of race, pointing out that racial minorities are overrepresented in the tax-disadvantaged lower-income groups (i.e., they are more likely to rent than to own their homes), which means that this violation of vertical equity also has discriminatory impact along racial lines. Ordower strenuously argues that this class- and race-based discrimination needs to be

addressed, either through the inclusion of imputed income from owner-occupied dwellings in gross income or by providing a deduction for rental payments for residences. After weighing the costs and benefits of each approach, Ordower expresses his preference for taxing imputed income rather than providing a deduction to renters.

In Chapter 5, Steve Johnson takes a mainstream perspective of the implicit exclusion from taxation of imputed income produced by owner-occupied dwellings. Johnson is sympathetic to Ordower's fairness arguments; however, he believes that it is unwise and impractical to tax imputed income. Although he concedes that the arguments in favor of taxing imputed income do have some purchase, Johnson dissects those arguments and explains why their force has been overstated.

Countering these (now diminished) arguments in favor of taxing imputed income, Johnson maintains that (1) homeowners would encounter reporting and recordkeeping problems if imputed income were taxed, (2) the IRS would encounter difficulties policing the taxation of imputed income, and (3) valuation problems would bedevil both taxpayers and the IRS if imputed income were taxed. Compounding these problems, Johnson points out the political difficulty of taxing imputed income. Not only would taxing imputed income be unpopular, but, according to Johnson, its lack of acceptance among taxpayers would also put an undue strain on our already strained self-assessment system of taxation. For all of these reasons, Johnson opposes the taxation of imputed income from owner-occupied dwellings. If any steps are to be taken to redress the fairness issues that Ordower raises in Chapter 4, Johnson is of the view that a deduction for renters would be preferable to taxing the imputed income produced by owner-occupied dwellings.

*Tax Accounting: Book–Tax Disparities*



Turning from questions of imputed income to tax accounting, Part III addresses so-called book–tax disparities—in other words, disparities between the reporting of income and expense for financial accounting purposes versus their reporting for tax accounting purposes. Contrary to the expectations of those who think of accounting as staid and boring, Lily Kahng and Adam Chodorow engage in a lively and fascinating debate about book–tax disparities. While finding some ground for agreement, Kahng and Chodorow see book–tax disparities in quite different lights.

In Chapter 6, Lily Kahng undertakes a historical examination of the differing natures and perceived purposes of financial and tax accounting. She explains how financial accounting has historically been conservative in its approach and tended to understate income because of its focus on providing information to stakeholders (e.g., shareholders and creditors). In contrast, tax accounting has historically tended to overstate income in order to protect the public fisc. More recently, however, the tables have turned and businesses have reported greater income for financial accounting purposes than they have for tax purposes. Against this background of an increasingly troubling book–tax gap, Kahng considers the question of whether there should be greater conformity between financial and tax accounting.

Kahng accepts some divergence between financial and tax accounting and finds the arguments in favor of book–tax conformity unpersuasive. Nevertheless, she does find that tax accounting might benefit from conforming more closely to financial accounting in its treatment of intellectual capital. In this area, Kahng argues that financial accounting is moving in the right direction while tax accounting is moving in the wrong direction. In order for tax accounting to more accurately measure income from intellectual capital,

Kahng argues that tax accounting should embrace the trend in financial accounting toward capitalization (rather than immediate expensing) of intellectual capital.

In Chapter 7, Adam Chodorow agrees with Kahng that tax accounting can learn some lessons from financial accounting. Nevertheless, he sees strong reasons not only for the extant divergence between the two accounting systems but also for pushing them further apart. In coming to this conclusion, Chodorow reexamines the historic justifications for the divergence between financial and tax accounting and comes away unconvinced. Instead, he proposes that the divergence between financial and tax accounting is most appropriately grounded in hewing to basic income tax principles.

In making this argument, Chodorow focuses in particular on the accrual method of accounting. He argues that Congress should eliminate that method of accounting and require all taxpayers to use the cash receipts and disbursements method of accounting. This argument flies in the face of the conventional wisdom that the accrual method provides a more accurate measure of income than the cash method. But Chodorow asserts that the purpose of tax accounting is not to obtain the most accurate measure of economic income; rather, it is to ensure that all income—including investment income—is taxed, and that it is taxed only once. By divorcing the receipt or payment of cash from the accrual of income and deductions, Chodorow contends that the accrual method of accounting violates the notion that returns on capital should be subject to tax and, as a result, turns the income tax into a consumption tax. If Congress is unwilling to rectify this problem by taking the drastic step of eliminating the accrual method of accounting, Chodorow argues in favor of increasing the IRS's ability to challenge taxpayers' methods of accounting when those methods result in exempting returns on capital from tax.

### *Entity Taxation*

Shifting from questions of how to account for items of income and deduction, Parts IV and V implicate the question of how to identify the appropriate taxpayer when taxpayers come together to operate a business. In a division that is natural to tax academics but in reality quite artificial, Part IV takes on the taxation of flow-through business entities while Part V takes on the taxation of corporations. Despite the division, the discussions in both of these parts share common (and perennial) themes regarding fairness and the potential for abusing the differing tax regimes applicable to different business entities.

### *Taxation of Flow-Through Entities*

In addressing the taxation of flow-through entities, Part IV focuses in particular on the partnership tax regime found in subchapter K of the Internal Revenue Code [Code]. Andrea Monroe and Bradley Borden make a notoriously arcane corner of an already arcane area of the law highly accessible with their debate over the future of subchapter K. Their differing perspectives—with Monroe focusing on the equity of subchapter K and Borden focusing on its efficiency—only make their contrasting contributions that much more interesting.

In Chapter 8, Andrea Monroe argues that subchapter K is broken and that the root of the problem lies in its focus on a small number of elite partnerships and attempts to combat their efforts to obtain undue tax advantages through abuse of the Code. This has led to the creation of a highly complex, technical tax regime that is nearly inaccessible to the more numerous “everyday” partnerships, which lack the resources to navigate subchapter K’s complexity. Monroe highlights the partnership allocation and distribution rules as examples of the complexity of partnership tax. She asserts that the inordinate complexity of rules such as these creates a division between everyday and elite partnerships

that undermines the rule of law, as everyday partnerships encounter a system designed for the wealthy under which they are relegated to merely guessing at the appropriate legal treatment of their operations.

Monroe contends that subchapter K could be made simpler and more accessible to everyday partnerships by refocusing the rules on governing ordinary transactions, essentially outsourcing the policing of abusive transactions to the general rules and tools for targeting tax abuse that are available outside of subchapter K and apply to the Code more generally. This shift in focus would permit the wholesale elimination of the many highly complex partnership tax rules that are designed to do no more than combat abuse. The overall result would not only be a simpler, more accessible partnership tax system but also one that would bolster the tax system's perceived legitimacy and, ultimately, the rule of law. In particular, Monroe makes a provocative proposal to begin taxing distributions of property from partnerships—in the name of achieving a system that, in the end, is simpler and more consistent with basic income tax principles.

In Chapter 9, Bradley Borden takes a different, more historical view of subchapter K. Borden examines the economic and historical origins of partnership taxation and concludes that complexity in the partnership tax rules stems not from staving off abusive taxpayer behavior but from grappling with the inherent complexity of the economic arrangements among even the simplest of partnerships. He also downplays the practical level of complexity encountered by everyday partnerships, asserting that they need not worry about complex antiabuse rules so long as they are not engaged in abusive behavior. For truly simple economic arrangements, Borden suggests the alternative of forming a small business (so-called "S") corporation, because the Code's subchapter S does not

permit the same level of flexibility in structuring economic arrangements as subchapter K does. Instead, subchapter S contemplates a simple, uniform sharing among co-owners.

Borden thus embraces the complexity of subchapter K. Where he suggests alteration is in deviations from the initial approach taken in crafting the rules that make up the partnership tax regime. In keeping with the nature of the economic arrangements among partners, Borden maintains that the crafting of partnership tax rules should be initially approached from the perspective that a partnership is really no more than an aggregate of its partners. Only where necessary for administrative convenience should the partnership be viewed as a separate entity. Borden explains the benefits of this approach using as examples the rules in subchapter K governing contributions to partnerships and transfers of partnership interests. In those rules, he asserts that Congress has mistakenly taken an entity-oriented starting point and added reparative aggregate rules, whereas an aggregate starting point would have resulted in rules that are more efficient and accurate—and possibly simpler. That his suggested approach might potentially lead to complexity in the partnership tax rules does not bother Borden because he sees complexity as inherent in the economic arrangements of all partnerships.

### *Taxation of Corporations*

Part V addresses the taxation of corporations. Yariv Brauner and I each approach the question of whether corporations should be taxpayers from different perspectives. I approach the question from a critical perspective while Brauner approaches it from a mainstream perspective.

In Chapter 10, Yariv Brauner issues a call to repeal the corporate tax. By way of background, Brauner summarizes the policy rationales articulated in support of the

corporate tax, traces the history of the corporation, summarizes research on the incidence of the corporate tax, and dissects the arguments that have traditionally been made in support of and against the corporate tax. Ultimately, Brauner concludes that there is no sound policy reason for keeping the corporate tax.

In coming to this conclusion, Brauner makes a move one might expect more from a critical tax scholar and argues that conservatives should support (rather than oppose) and liberals should oppose (rather than support) the corporate tax. Brauner argues that liberals should advocate repeal of the corporate tax (and its replacement by a mere withholding mechanism for the individual income tax) because it would lead to greater redistribution of income. Moreover, Brauner advocates abandoning the corporate tax because policy makers cannot effectively control the corporate tax as a tax policy instrument as a result of their inability either to determine the incidence of the tax or to evaluate its effects on natural persons.

In Chapter 11, I approach the corporate tax reform debate from a different perspective—more as an outsider than an insider, such as Brauner. I compare the tenor of the corporate tax reform debate with the tenor of the debate over reforming the taxation of the family. I explain how families and corporations are both sociolegal constructs that actually receive very similar treatment for tax purposes: Both families and corporations are sometimes ignored for federal tax purposes. At other times, families and corporations are treated as an aggregate of individual family members or of shareholders. And at yet other times, families and corporations are treated as real entities. Each of these different treatments comes with different tax consequences.

Yet, despite the strong similarities in the taxation of families and corporations, the debates over corporate tax reform and family tax reform widely diverge. The corporate tax reform debate tends to center on leveling down the taxation of corporations to approximate the taxation of partnerships and disregarded entities; that is, it focuses on eliminating the “double” taxation of corporations in favor of the single level of taxation that applies to flow-through entities. In contrast, the family tax reform debate tends to center on leveling out or up; that is, its focus is on reworking or expanding the special tax treatment of the family to better tailor it to economic reality and tax policy norms, all while addressing issues of gender equity that have historically plagued the institution of marriage. The basic purpose of my highlighting these similarities and differences is to draw attention to—and, I hope, erase—a portion of the public–private divide that pervades the tax laws by showing that those engaged in the corporate tax reform debate might actually learn some lessons from the debate over reforming the taxation of the family.

### *Transfer Taxation*

Up to this point, the contributions to this volume have predominantly concerned varying aspects of the federal income tax. To close the volume, Part VI significantly changes course by focusing on the separate federal transfer tax system—that is, the federal estate and gift taxes. Joseph Dodge contributes a chapter that considers the design of the federal transfer tax system from a mainstream perspective. Bridget Crawford and Wendy Gerzog together contribute a chapter that considers from a critical perspective the advent of “portability” of the lifetime gift/estate tax exemption.

In Chapter 12, Joseph Dodge does a thorough job of disentangling the norms underpinning transfer taxation—both those internal to the tax system and those external to

the tax system. The internal-to-tax norms that Dodge identifies are fairness and administrative efficiency. The external-to-tax norms that he identifies are economic efficiency and distributive justice. Against this background, Dodge posits that the primary rationales for transfer taxation are (1) to advance the fairness norm of ability to pay (whether generally or as an enhancement of the progressivity of the federal income tax) and (2) to act as a curb on excessive concentrations of wealth received by gift or inheritance.

Approaching the question of design of the federal transfer-tax system from a traditional academic perspective, Dodge maintains that, consistent with the above-mentioned rationales, a tax on gratuitous transfers ought to be imposed on transferees. The tax either could take the form of a separate accessions tax or could be folded into the federal income tax by including gratuitous transfers in gross income. Dodge contends that which form the tax takes depends on whether one is more concerned with ability to pay or with curbing excessive concentrations of wealth. To avoid sacrificing either end, Dodge suggests that the income-inclusion approach could actually be combined with an accessions tax (so long as the accessions tax had a large exemption amount and high rates).

In Chapter 13, Bridget Crawford and Wendy Gerzog pick up a thread of Dodge's discussion and focus on the distortions redressed and created by the advent of "portability" to the federal gift and estate taxes. Crawford and Gerzog provide helpful background by explaining the common estate planning mistakes that married couples made in the pre-portability era by failing to take full advantage of their lifetime gift/estate tax exemptions. They then explain how portability of the exemption may simplify estate planning and effectively remove the source of those common mistakes.



But Crawford and Gerzog then go beyond the typical academic discussion of tax rules by looking at the impact of portability on the economic and power dynamics in married couples, especially on women because they are statistically more likely to be the poorer spouse in a married couple. Crawford and Gerzog also critically examine the ways in which portability further reifies the married couple as a taxable unit and troublingly distributes tax benefits based on sexual relationships. Like Dodge, Crawford and Gerzog are concerned by the distortionary effects of the tax system; however, their focus is that of the critical tax scholar, as they interrogate the structure and function of the law, its privileging of certain (i.e., marital) relationships over others, and its impacts along lines of gender (as well as class, race, sexual orientation, etc.).

### **A Few Words of Thanks**

Working on this book has been a pleasure. I would like to thank Anne Richardson Oakes for asking me to consider editing this volume on controversies in tax law and my editors at Ashgate for embracing the idea of a book that would ask contributors to actively engage with each other and their unique perspectives on U.S. tax law. I have thoroughly enjoyed working with all of the contributors to this volume, who have made my job of editing an exceedingly easy and pleasurable one. I appreciate their patience as they signed on to—and then diligently carried out—a project in which I asked them to produce three separate drafts of their chapters: an initial draft that they exchanged with each other early on so that they could begin to take each other’s perspectives into account in producing the initial draft that I would review; a second draft for my review (and which was again exchanged); and

then a final draft. Watching the chapters take shape through this process was exciting, and I am quite pleased with the end product. I hope that you will be as well.